STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6107

Tariff filing of Green Mountain Power Corporation)
requesting a 12.9% rate increase, to take effect)
June 22, 1998)

PREFILED TESTIMONY OF WILLIAM STEINHURST ON BEHALF OF THE VERMONT DEPARTMENT OF PUBLIC SERVICE

September 18, 1998

Summary: The purpose of Dr. Steinhurst's testimony is to review the conclusions of the Department's witnesses on the Hydro Quebec Contract, to explain the Department's position regarding that Contract, and to recommend the rates that should be set for the Company.

Prefiled Testimony of William Steinhurst

Q. Please state your name and occupation.

A. My name is William Steinhurst, and I am the Director for Regulated Utility Planning for the Vermont Department of Public Service ("Department", "DPS"). My business address is 112 State Street, Montpelier, Vermont.

Q. Have your previously testified before this Board?

A. Yes. Please see Attachment A, page 4, Exhibit DPS___(WS-1).

Q. Please summarize your relevant educational and work experience.

A. Please see attached Exhibit DPS___(WS-1).

Q. What is the purpose of your testimony?

A. I will review the testimony and recommendations of the Department's witnesses on certain matters regarding the Hydro Quebec-Vermont Joint Owner's power purchase contract ("HQ contract," "the Contract") and the financial situation of Green Mountain Power ("GMP," "the Company"). I also provide the Department's recommendation for rate treatment of the Contract and overall rates and explain why the Board should follow that recommendation.

Q. Does the Department have a rate making recommendation regarding those issues?

A. It has been very difficult to formulate a position that balances our concerns about ratepayers bearing excessive power costs and maintaining a Company that has the financial capacity to provide safe and reliable service. Obviously, triggering insolvency in the very

near term is not to be taken lightly. However, I believe that the following recommendations fairly and responsibly resolve these concerns.

Q. What are the Department's rate making recommendations regarding those issues?

A. The Board, having determined in Docket 5983 that the premature lock in of the Contract was imprudent, should disallow all of the above market costs of the Contract in accordance with traditional rate making. That amount is estimated at $22,400,000. As DPS witness Dirmeier testifies, the resulting rate impact of that disallowance along with the other adjustments and disallowances recommended by the Department would result in a net *decrease* in revenues of $5,764,000 or 3.575%, again in accordance with traditional rate making. However, because setting rates now at that level would have very serious consequences and for others reasons explained below, the Board should temporarily depart from traditional rate making and allow in rates an additional amount that would result in a temporary rate increase of $7,248,000 or 4.50%, but only if it also orders *now*, as a condition of allowing those additional revenues, that their collection will expire on their own terms in one year. In other words, the Board should order that, at the end of one year, rates will revert to a level 3.575% below existing rates, absent further order of the Board. The Board should also make clear that such a further order will be issued only upon a showing that ratepayers will not bear excessive costs in the future. I recommend rates be temporarily set 4.50% above existing rates because I believe that is the least amount that will ensure that the Company is financially viable for the rate year and will enable the Company to deliver service that meets or exceeds the standards set in 30 V.S.A. § 226(a).

The additional allowance, its size, and making it automatically expire after one year are intended to achieve several purposes: to allow a reasonable amount of time for the Company to cut its above market power costs; to enable adequate service to customers during that period; to provide time for Vermont to prepare for the possibility that those

power costs may not be mitigated; and to strongly motivate the Company and its power suppliers to cut those above market power costs. For these reasons and others explained below, it is in the public interest to make the additional rate allowances, but only if that is done with the restrictions and conditions recommended in this testimony.

The additional allowance should be in the form of a one year forbearance on the full prudence disallowance of costs under the Contract, temporarily reducing that disallowance to $9,500,000 for one year, but only on the condition that the forbearance would expire automatically at the end of one year, as well as certain other conditions described below. That forbearance has the effect of disallowing about 42% of the imprudent Contract costs in the first year of the disallowance, as opposed to 100% of those imprudent costs.

Q. What is the reason for imposing so severe an initial disallowance, yet recommending that the Board forbear applying the full amount?

A. I recommend imposing the full prudence disallowance to ensure that there is maximum pressure created to bring about substantial long term power cost mitigation to benefit the Company and its ratepayers. I recommend a one year forbearance on that disallowance to ensure that there is time to achieve that mitigation and so that utility service will be safe and reliable in the meantime. The recommended amount of the forbearance is just enough to ensure that result. Lastly, I recommend that the full disallowance apply after one year so that the forbearance will not cancel the incentives created by the disallowance.

Q. Why are the correct damages from the imprudent premature lock in $22,400,000 in the rate year?

A. DPS Witness Chernick demonstrates clearly and convincingly why, if the Company had not locked into the Contract in August 1991, the power costs it would be incurring in

the rate year for alternative sources would be at or near the current market price. A reasonable estimate of the current market price is the average of the DPS Mid and DPS Low Market cases as presented in the testimony and exhibits of DPS witness Biewald. Resulting above market costs for the Contract for 1999, which closely approximates the rate year, are $18.0 million and 26.6 million in those two cases respectively, yielding an average of $22.4 million.

The Board remarked in its Docket 5983 Order that sound power planning would call for a mix of resources and not just short term market purchases. This is correct and would be applicable here if the Company were constructing today a proper least cost plan to replace the Contract over the long term. But that is not the relevant question for determining the damages from the premature lock in. Rather, it is necessary to consider what would have happened, assuming sound power planning decisions, given the circumstances obtaining between August, 1991, and today. It is my opinion that if GMP had been acting properly over that time period, it would have acquired less than a full replacement for the Contract, would have relied on a combination of spot, short term (one year or less) and medium term (approximately one to five year) purchases for several years, and by that time would have begun acquiring some longer term resources by purchases with resources much like those available at current market prices. The evolution of power purchase decisions discussed by Mr. Chernick shows that this is a reasonable conclusion.

Q. What are the other conditions you referred to above?

A. As DPS witness Dunn testifies, the Company needs to greatly improve its right of way ("ROW") maintenance and pole testing programs in order to provide safe and reliable service. The shortcomings identified are serious and long standing. Remedying them will require significant additional expenditure in the rate year (and after). Since the Department's rate recommendation will place significant financial pressure on the

Company, as it is intended to do, there would be a significant risk that funds allowed in rates for these purposes might be diverted. Also, it is not possible to state with precision at this time how much money is required in addition to the $815,000 in the current budget or exactly what should be done to improve these programs. Therefore, I recommend that an adjustment to the cost of service in the amount Mr. Dunn's recommended additional expenditure of $1,000,000 be made, but only on the following conditions.

1. The Company should be ordered to promptly prepare plans for enhanced ROW maintenance and pole testing. The plans should reflect both a proper level of ongoing activity and catching up on the backlog within a reasonable period. The Company should file those plans with the Department and Board for review and approval. The Board should set a specific deadline for that filing.

2. The Company should be ordered to implement the approved plan.

3. Mr. Dunn's recommended additional expenditure of $1,000,000 is only an estimate of what will be required. The Board should order that if the amount actually expended in accordance with the approved plan for these activities during any year minus the amount in the Company's filed cost of service for those activities is less than $1,000,000 then the difference should be applied to reduce a deferral account designated by the Board.

Q. Would the Company be able to continue to deliver safe and reliable service and to meet its obligations under Vermont utility law if the Board were to adopt your rate recommendation, along with the above conditions?

A. Yes. DPS witness Ross has examined the Company's financial situation and

concluded that the Company can continue to operate normally, albeit only with stringent cash conservation measures he characterizes as "self-help" by the Company. It is my understanding that the Company would not need to incur writeoffs under FAS 5 or FAS 71 if the disallowance order is properly structured. It is not the intention of the DPS to trigger a FAS 5 or a FAS 71 write-off as a result of the Board's order in this docket. And, Mr. Ross testifies that the Company should have access to sufficient capital during the rate year to meet its needs for cash at reasonable rates and on reasonable terms. The Company may, of course, request an emergency rate increase if it believes it must to deliver safe and reliable service.

Q. Why would a FAS 71 write off not be required?

A. It is my understanding that because the recommended disallowance is entirely a prudence disallowance, the resulting rates are still cost based rates.

Q. Why would a FAS 5 write off not be required?

A. It is my understanding that such a writeoff would be required only if *both* the following conditions are met: (1) the relevant loss is probable and (2) the relevant loss is reasonably estimable. I understand that reasonably estimable implies that if a range of values for the relevant loss can be reasonably estimated, the low end of that range may need to be written off, but, again, only if the first condition is also met.

With regard to probability, it is my opinion that if the Board issues an order in accordance with the recommendations I make in this testimony and thereby gives the Company the new tool it needs to pursue serious and prompt mitigation, and assuming vigorous efforts by the Company, the Company will not be likely to incur a relevant loss. Also, the VJO dispute with HQ regarding reliability of the Contract could prevent a relevant loss.

As to estimability, several facts make it possible that the range of estimates for the

relevant loss (if it were judged "probable") would include zero, so that a FAS 5 writeoff would, again, not be required. These facts include (1) that future market costs and the performance of the Contract are both uncertain, so that the future above market cost of the Contract is also not known and would depend on uncertain projections, (2) the VJO/HQ reliability dispute, (3) the uncertainty about the amount of mitigation that will be obtained by the Company from HQ and other power suppliers, and (4) the extremely important point that the Board will not have made a determination of rates after the rate year. Some or all of these could combine to result in a range of reasonable estimates (as of the time the Board issues an order in the current proceeding) that could include zero.

Q. In Docket 5983, you recommended only a smaller and interim disallowance, along with certain proposed follow on proceedings. Why have you changed your position?

A. Since that testimony was offered and since the Board issued its Order in that docket, I have become convinced that the interim disallowance strategy is not in the public interest. That strategy was intended to motivate the Company and its power supply creditors to seek rapid and significant mitigation of the Company's excessive power costs prior to the targeted date for a final disposition of the Contract disallowances. It was also intended to prompt the Company to take strong measures to cut costs overall. Neither of those intended results appears to be happening.

While GMP has engaged in various projects to cut operational costs for the long term and those projects reflect well on GMP staff, the Company's management seems focused on changes that are relatively small and in some instances detrimental to utility service. In the meantime, very large outlays continue unchecked, very large and unnecessary expenditures are made voluntarily by the Company, and there is no sign of significant power cost mitigation. An interim disallowance, despite the clear risk of potential larger disallowances in the future, has not resulted in the kind of multi-million dollar cost savings necessary to ensure that Vermont ratepayers will not bear excessive

costs. Clearly, decisive action is needed to effect any genuine savings for ratepayers.

Q. Why, then, do you recommend that the Board set rates in this case using the uncommon practice of a forbearance on an imprudence disallowance?

A. There are several reasons. First, the recommended approach leaves the Company functioning and financially viable for one year. However, since a large part of the rates granted expire on their own terms on a date certain, one year from the Board's Order, there is a credible expectation that this state of affairs is not to be counted on unless certain conditions are found by the Board to have already been met *before that date*. This is the key to my recommendation. Second, Vermont needs time to prepare for the potential consequences in case the desired power cost mitigation is not forthcoming. For instance, the Board has initiated a formal investigation to examine ways of reducing excessive power costs in Vermont that will take time. Also, the Governor has appointed a Working Group on Vermont's Electricity Future; this group is not expected to issue its recommendations until December, and any recommended actions, such as legislation or litigation, would require further time. Third, it will take time to assess the concerns of the municipal and other Vermont electric utilities that could be affected by step up provisions in the event that satisfactory power cost reductions are not obtained by GMP. Fourth, it is reasonable to refrain from triggering drastic consequences while the Board's Order in Docket 5983 is still under appeal. Fifth, the Vermont Joint Owners (the utilities that signed the Contract) are engaged in a dispute resolution process with HQ regarding HQ's performance under the Contract, a dispute that may result in benefits to the Vermont Joint Owners that should be taken into account in any final decisions. And lastly, the very serious consequences that could be triggered by a full disallowance are not to be triggered lightly.

In my judgement, ratepayers will benefit from the forbearance on the imprudence disallowance. This is because they will obtain risk reduction benefits and potential benefits

from maintaining the status quo pending the activities listed above, while also benefitting from the much more credible motivations provided the Company and its creditors to act promptly on mitigation.

Q. How can the Company maintain financial viability in the face of such disallowances?

A. First of all, the Company has a number of very large cash conservation measures it can take at this time. These include discontinuing common stock dividends, continuing various measures to cut operating costs, and ceasing additional investments in unregulated subsidiaries, including Mountain Energy and the Company's water heater rental business. There may be portions of the Company's capital additions budget for 1999 that could be deferred, omitted or reduced without significant impact on safety, reliability and ability to serve. No doubt these measures would have consequences, but these must be considered in context. The Company might argue that omitting dividends would make it harder to raise equity capital. But the Company could not reasonably expect to do so on favorable terms in any case until the excess power cost situation is resolved.

The additional rate allowance recommended above, together with the above cash conservation measures, will not completely suffice to enable the Company to remain financially capable of providing the appropriate level of service. However, as Mr. Ross testifies, they would leave the Company in a position permitting it to take on additional debt. He also testifies that such financing is readily available to similarly situated utilities under terms and conditions tolerable in a situation like the Company's.

Q. Do GMP witnesses appear to be disputing the Board's Docket 5983 findings that Contract is imprudent and not used and useful? Or are those GMP witnesses saying that in any case, the damages from locking in the Contract were nil?

A. It seems they are doing both, although the testimony is unclear in some respects.

Q. Given that GMP testimony, and if the Board does not accept your recommendations regarding rate making in this Docket, should the Board undo its findings and disallowances from Docket 5983?

A. Absolutely not. First of all, it is my understanding that the findings that the lock in was imprudent and that the Contract is not used and useful are not subject to relitigation. Department witnesses have been asked to address such testimony only in order to ensure that erroneous or misleading testimony does not appear unrebutted and not to assert that the GMP testimony addresses issues of relevance to this Docket. To the extent that the current proceeding might include some kind of reconsideration of the wisdom of the used and useful policy (not the findings of fact regarding that policy), DPS witnesses have convincingly rebutted the testimony of the GMP witnesses. As to the HQ Contract disallowance in Docket 5983, the Board should certainly disallow at least that amount. DPS witness Lamont testifies that applying the formula employed in the Docket 5983 Order to the facts regarding 1999 (approximately coincident with the rate year), would be $7.595 million.

Q. Please summarize the benefits of your recommended rate making policy.

A. My recommended rate making approach and rate level ensures that proper utility service can be provided, establishes a set time within which mitigation may be developed, will pointedly motivate the Company and its power suppliers to do so, provides for significant rate savings whether or not that mitigation is delivered, and permits other parties that may be affected to prepare for the possibility that power cost mitigation may not be achieved.

Q. Does that complete your testimony at this time?

A. Yes.